Supreme Court, U.S.
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90-657

No.

IN THE
Supreme Court of the United States
OCTOBER TERM, 1990

KEMPER FINANCIAL SERVICES, INC.,
Cross-Petitioner,

v.

JILL S. KAMEN,
Cross-Respondent.

CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Joan M. Hall*
Joel T. Pelz
C. John Koch
JENNER & BLOCK
One IBM Plaza
Chicago, Illinois 60611
(312) 222-9350

Attorneys for Cross-Petitioner Kemper Financial Services, Inc.

* Counsel of Record

QUESTION PRESENTED

Whether the due process clause requires a shareholder bringing a suit "on behalf of" an investment company under Section 36(b) of the Investment Company Act of 1940 to be an adequate representative of other shareholders whose interests the shareholder purports to represent and who will be bound by the judgment?

RULE 29.1 LISTING

In addition to the parties listed in the caption of this cross-petition, Cash Equivalent Fund, Inc. was a party in the proceedings below.

The following are parent corporations and subsidiaries (not wholly owned) of cross-petitioner Kemper Financial Services, Inc.:

Parent Corporations:

Kemper Financial Companies, Inc.
Kemper Corporation
Lumbermens Mutual Casualty Company

Subsidiaries Not Wholly Owned:

Dimensional Fund Advisers, Inc.
Investors Fiduciary Trust Company
Kemper International Management, Inc.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
RULE 29.1 LISTING	ii
OPINIONS BELOW	1
JURISDICTION	2
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	2
STATEMENT OF THE CASE	2
REASONS FOR GRANTING THE CROSS-PETITION IN THE EVENT THAT THE COURT GRANTS THE PETITION IN NO. 90-516	6
I. THE SEVENTH CIRCUIT'S HOLDING, THAT A SECTION 36(b) SUIT IS A PERSONAL RATHER THAN A REPRESENTATIVE ACTION AND THAT THE PLAINTIFF CONSEQUENTLY NEED NOT BE AN ADEQUATE REPRESENTATIVE OF OTHER SHAREHOLDERS, CONFLICTS IN PRINCIPLE WITH ESTABLISHED PRECEDENTS OF THIS AND OTHER COURTS	6
II. THE SEVENTH CIRCUIT'S HOLDING, THAT A SHAREHOLDER WHO BRINGS A SECTION 36(b) SUIT IS AN ADEQUATE REPRESENTATIVE OF THE OTHER SHAREHOLDERS SOLELY BECAUSE HER LAWYER IS COMPETENT, CONFLICTS WITH ESTABLISHED PRECEDENTS OF THIS AND OTHER COURTS	8
CONCLUSION	11

TABLE OF AUTHORITIES
CASES

	Page
Ashare v. Brill, 560 F. Supp. 18 (S.D.N.Y. 1983)	7
Bailey v. Patterson, 369 U.S. 31 (1962)	10
Bailey v. Ryan Stevedoring Co., 528 F.2d 551 (5th Cir. 1976), *cert. denied*, 429 U.S. 1052 (1977)	9
Blatt v. Dean Witter Reynolds Intercapital, Inc., 732 F.2d 304 (2d Cir. 1984)	7
Burks v. Lasker, 441 U.S. 471 (1979)	7
Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541 (1949)	8, 10
Daily Income Fund, Inc. v. Fox, 464 U.S. 523 (1984)	7, 8
Davis v. Comed, Inc., 619 F.2d 588 (6th Cir. 1980)	11
Dierks v. Thompson, 414 F.2d 453 (1st Cir. 1969)	9
Gartenberg v. Merrill Lynch Asset Management, Inc., 573 F. Supp. 1293 (S.D.N.Y. 1983), *aff'd*, 740 F.2d 190 (2d Cir. 1984)	7
Hansberry v. Lee, 311 U.S. 32 (1940)	9, 10
Krasner v. Dreyfus Corp., 500 F. Supp. 36 (S.D.N.Y. 1980)	7
Lerner v. Reserve Management Co., [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,036 (S.D.N.Y. 1981)	7
Meyer v. Oppenheimer Management Corp., 764 F.2d 76 (2d Cir. 1985)	7
Newman v. Stein, 464 F.2d 689 (2d Cir.), *cert. denied*, 409 U.S. 1039 (1972)	7
Owen v. Modern Diversified Indus., 643 F.2d 441 (6th Cir. 1981)	9
Phillips Petroleum Co. v. Shutts, 472 U.S. 797 (1985)	8

Page

Rothenberg v. Security Management Co., 667 F.2d 958 (11th Cir. 1982) 11

Schlusselberg v. Colonial Management Assoc., Inc., 389 F. Supp. 733 (D. Mass. 1974) 7

CONSTITUTIONAL PROVISIONS AND STATUTES

Due process clause, U.S. Const. amend. V . . . . . passim

15 U.S.C. § 80a-35(b) . . . . . passim

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Cross-petitioner Kemper Financial Services, Inc. ("KFS") respectfully requests that this Court, solely in the event that it grants review with respect to one or more of the questions presented in No. 90-516, also grant review of an additional holding of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The opinions of the United States District Court for the Northern District of Illinois, which are reproduced in the appendix to the petition in No. 90-516 ("Pet. App.") at 73a-83a, are not officially or unofficially reported. The opinion of the United States Court of Appeals for the Seventh Circuit (Pet. App. 1a-32a) is reported at 908 F.2d 1338 (1990).

JURISDICTION

The decision of the court of appeals was rendered on July 18, 1990. This cross-petition is being filed pursuant to Supreme Court Rule 12.3 in connection with the petition in No. 90-516. That petition was received on September 21, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Fifth Amendment to the United States Constitution provides in pertinent part:

> No person shall . . . be deprived of life, liberty, or property, without due process of law. . . .

Section 36(b) of the Investment Company Act of 1940, 15 U.S.C. § 80a-35(b), which is set forth in its entirety at Pet. App. 96a-98a, provides in pertinent part:

> An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment adviser . . . for breach of fiduciary duty in respect of such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person. . . .

STATEMENT OF THE CASE

This conditional cross-petition presents the question whether the named plaintiff in a Section 36(b) action, brought on behalf of a mutual fund, must be an adequate representative of the other shareholders of the fund.

In 1985, petitioner Jill S. Kamen ("plaintiff"), as a shareholder of Cash Equivalent Fund, Inc. (the "Fund"), filed this federal action against cross-petitioner KFS and the Fund. Plaintiff alleged that KFS, which serves as the investment adviser and underwriter of the Fund, had breached its fiduciary duties under Section 36(b) by charging the Fund excessive advisory fees. Plaintiff alleged that her claim was brought "on behalf of the Fund" (Pet. App. 86a), and she sought to recover for the Fund all allegedly excessive fees paid to KFS.

The Fund is a special type of money market mutual fund that differs from ordinary "retail" money market funds. The Fund is designed specifically to be linked to securities trading accounts at brokerage firms and to be sponsored by those firms. The Fund is used to provide cash management services for securities-trading clients of brokerage firms to minimize idle trading-account balances that otherwise would not collect interest. When clients have positive balances in their brokerage accounts, those balances automatically are swept into the Fund so that the clients' funds earn interest while awaiting investment in other securities. When clients need cash to settle securities transactions or for related purposes, the shares in the clients' Fund accounts automatically are redeemed, and the proceeds are transferred to the clients' brokerage accounts. Depending upon the sponsoring brokerage firm, the Fund also has available various check-writing privileges and related services. *See* Pet. App. 1a-2a.

Essentially all of the Fund's accounts are linked with securities-trading accounts at brokerage firms, and those sponsoring firms must be compensated for their efforts and facilities in connection with providing cash management services. Consequently, if other factors are equal, retail money market mutual funds generally offer shareholders a higher yield on their investments than do broker-sponsored money market mutual funds. The Fund is designed specifically for investors who (a) desire the added services that the Fund provides, and (b) are willing to pay for those services in the

form of somewhat higher fees and fractionally lower yields. *See* Pet. App. 2a-3a; 26a-27a.[1]

It is undisputed that plaintiff, unlike most shareholders in the Fund, has never used any of the services that make the Fund different from ordinary retail money market funds and serve as the basis for its higher fees and lower yields. In the seven years that she maintained a Fund account, plaintiff never used the funds in her account to trade securities or to invest in bonds, certificates of deposit or other mutual funds. During that period, plaintiff made only two or three deposits into the account and never made a redemption or withdrawal. *See* Pet. App. 27a.[2]

Because plaintiff filed her suit in a representative capacity "on behalf of the Fund" (Pet. App. 86a), KFS moved for summary judgment on the issue of plaintiff's adequacy as a representative of all Fund shareholders. The district court referred the motion to a United States Magistrate for a report and recommendation. (Pet. App. 73a.)

The Magistrate examined the evidence and, stressing that plaintiff did not use any of the Fund's special services, concluded that "plaintiff's interests are antagonistic to those of the other shareholders," and that "plaintiff cannot adequately protect those interests." (Pet. App. 77a.) After

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[1] The Fund's shareholders expressly approved the Fund's combination of added services for moderately-higher fees on two occasions, one of which was after the shareholders were notified of plaintiff's claims in this litigation. (Pet. App. 74a-76a.)

[2] Discovery in the proceedings below further revealed that plaintiff knew virtually nothing about the suit or its prosecution, and had abandoned all responsibility for it to her counsel. *See* Pet. App. 25a. For example, plaintiff admitted in her deposition that she had not made any investigation of the facts underlying the lawsuit before or after signing the complaint, had no idea what had happened during the pendency of the suit, had not paid any of the expenses of the suit, did not understand who had received the fees at issue, and did not know which parties were named as defendants. *See* Pet. App. 25a-26a.

reviewing the evidence, the district court adopted the Magistrate's recommendation and granted KFS's motion for summary judgment on the issue of plaintiff's adequacy as a representative. Accordingly, the district court entered judgment for the defendants.[3]

On plaintiff's appeal from the district court's final judgment, the Seventh Circuit agreed that "[d]ue process requires adequate representation . . . when the plaintiff is *representing* someone else." (Pet. App. 24a; emphasis in original.) However, the Seventh Circuit held that plaintiff's suit under Section 36(b) was a personal action rather than a representative one: "Kamen represents no one other than herself. . . . [T]he right at stake is personal. . . . " (*Id.*) Consequently, the Seventh Circuit held that the due process clause did not require that plaintiff be an adequate representative of other shareholders. (*Id.*)

The Seventh Circuit further held that even if the adequate-representation requirement did apply, plaintiff was a proper plaintiff because, regardless of the antagonism between her interest and that of the absent class members, as well as her obliviousness to the issues presented in the litigation, her lawyer could act as the true class representative and competently pursue the litigation. The court stated: "Securities actions, like many suits under Rule 23, are lawyers' vehicles. . . . When defendants' counsel took Kamen's deposition and learned that she knew little about either the Fund or the case and had given counsel free reign, they learned only that this case fits the norm." (Pet. App. 25a.)

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[3] The district court also entered judgment for the defendants on plaintiff's other claims. That part of the judgment was affirmed by the Seventh Circuit (Pet. App. 6a-21a), and plaintiff has sought review thereof in No. 90-516.

REASONS FOR GRANTING THE CROSS-PETITION IN THE EVENT THAT THE COURT GRANTS THE PETITION IN NO. 90-516

In its Brief In Opposition to the Petition for a Writ of Certiorari in No. 90-516 ("90-516 Br. Opp."), KFS demonstrates that review of the Seventh Circuit's decision in this case is not warranted. The Seventh Circuit's decision does not conflict with decisions of this Court or of other courts of appeal on the issues raised in the petition. (90-516 Br. Opp. at 9-15.) Moreover, the principal question that plaintiff seeks to present for review is academic (that is, no possible resolution of the issue could affect the outcome of this case), and prudential factors strongly militate against further review by this Court. (90-516 Br. Opp. at 5-8.)

However, if this Court grants review in No. 90-516, it also should review the important issue raised in this cross-petition: whether the due process clause requires that a shareholder bringing a Section 36(b) suit "on behalf of" an investment company be an adequate representative of the company's other shareholders. U.S. Const. amend. V. The potential impact of the Seventh Circuit's holding extends beyond Section 36(b) actions and affects the law applicable to all types of derivative suits and class actions.

I. THE SEVENTH CIRCUIT'S HOLDING, THAT A SECTION 36(b) SUIT IS A PERSONAL RATHER THAN A REPRESENTATIVE ACTION AND THAT THE PLAINTIFF CONSEQUENTLY NEED NOT BE AN ADEQUATE REPRESENTATIVE OF OTHER SHAREHOLDERS, CONFLICTS IN PRINCIPLE WITH ESTABLISHED PRECEDENTS OF THIS AND OTHER COURTS.

The Seventh Circuit's holding, that plaintiff need not be an adequate representative of other shareholders because her

Section 36(b) suit is a "personal" rather than "representative" action, conflicts in principle with numerous decisions of this and other courts.

In similar contexts, courts uniformly have held that Section 36(b) suits require basic due process protections that are unique to representative suits, such as court approval of settlements and the sending of notice to absent shareholders. *See, e.g., Meyer v. Oppenheimer Management Corp.*, 764 F.2d 76, 79 (2d Cir. 1985).[4] The representative nature of Section 36(b) suits also underlies the conclusion that judgments in Section 36(b) actions bind everyone who was a shareholder during the subject time period, including those who are absent. *See, e.g., Gartenberg v. Merrill Lynch Asset Management, Inc.*, 573 F. Supp. 1293, 1299 (S.D.N.Y. 1983), *aff'd*, 740 F.2d 190 (2d Cir. 1984).[5]

This Court likewise has recognized that, because Section 36(b) expressly requires that shareholder suits under its provisions be brought "on behalf of" the company, Section 36(b) actions are derivative, and hence representative, in nature. *Burks v. Lasker*, 441 U.S. 471, 477, 484 (1979) ("A derivative suit is brought by shareholders to enforce a claim on behalf of a corporation. . . . Section 36(b) . . . [allows] derivative suits charging breach of fiduciary duty with respect to adviser's fees"); *Daily Income Fund, Inc. v. Fox*, 464 U.S.

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[4] *See also, e.g., Blatt v. Dean Witter Reynolds Intercapital, Inc.*, 732 F.2d 304, 306 (2d Cir. 1984); *Newman v. Stein*, 464 F.2d 689, 691 (2d Cir.), *cert. denied*, 409 U.S. 1039 (1972); *Ashare v. Brill*, 560 F. Supp. 18, 19 (S.D.N.Y. 1983); *Krasner v. Dreyfus Corp.*, 500 F. Supp. 36, 41 (S.D.N.Y. 1980); *Schlusselberg v. Colonial Management Assoc., Inc.*, 389 F. Supp. 733, 741 (D. Mass. 1974).

[5] *See also, e.g., Ashare v. Brill*, 560 F. Supp. 18, 21 (S.D.N.Y. 1983); *Lerner v. Reserve Management Co.*, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,036 at 91,368 (S.D.N.Y. 1981). The Seventh Circuit here acknowledged that plaintiff's Section 36(b) action binds all shareholders, "extinguishing the claim against" KFS. (Pet. App. 26a.)

523, 535 n.11 (1984) ("[A] § 36(b) action is undeniably 'derivative' in the broad sense of that word"); *see Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 549 (1949) ("[A] stockholder who brings suit on a cause of action derived from the corporation assumes a position . . . as representative of a class comprising all who are similarly situated. . . . He is a self-chosen representative and a volunteer champion.").[6]

The law is clear that in derivative suits and other representative actions, "the Due Process Clause . . . requires that the named plaintiff at all times adequately represent the interests of the absent class members." *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 812 (1985).

The rationale underlying the Seventh Circuit's holding clearly conflicts with that underlying the foregoing decisions of this Court and of the other courts of appeals. In the event that this Court grants review in No. 90-516, it also should grant review with respect to this question.

II. THE SEVENTH CIRCUIT'S HOLDING, THAT A SHAREHOLDER WHO BRINGS A SECTION 36(b) SUIT IS AN ADEQUATE REPRESENTATIVE OF THE OTHER SHAREHOLDERS SOLELY BECAUSE HER LAWYER IS COMPETENT, CONFLICTS WITH ESTABLISHED PRECEDENTS OF THIS AND OTHER COURTS.

The Seventh Circuit's decision that the plaintiff must be deemed a proper representative in any event, despite the antagonism of her interest to that of other class members, as

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[6] Other characteristics of Section 36(b) actions, and of plaintiff's action in particular, confirm that Section 36(b) suits are representative actions rather than personal ones. Plaintiff seeks to recover all fees purportedly owed to the Fund, and not just plaintiff's proportional share of those fees. (Complaint's Prayer, Pet. App. 93a; *see* Section 36(b)(4).) Moreover, any recovery goes not to plaintiff personally, but to the Fund for the benefit of all shareholders. (*Id.*; *see Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 535 n.11 (1984).)

well as her obliviousness to the issues presented in the litigation, likewise conflicts with established precedent from this and other courts.

As several courts of appeals have held, a representative lawsuit is an impossibility when members of the purported class do not desire the same result:

> Unless the relief sought by the particular plaintiffs who bring the suit can be thought to be what would be desired by the other members of the class, it would be inequitable to recognize plaintiffs as representative, and a violation of due process to permit them to obtain a judgment binding absent plaintiffs.

Dierks v. Thompson, 414 F.2d 453, 456 (1st Cir. 1969).[7] That body of precedent rests on this Court's seminal decision in *Hansberry v. Lee*, 311 U.S. 32 (1940), which allowed absent plaintiffs in a purportedly representative suit to attack collaterally the judgment because they desired something different than did the named plaintiffs. *Hansberry* and its progeny hold that the due process clause prohibits a named plaintiff from representing absent plaintiffs with conflicting interests.

The Seventh Circuit departed from that principle in the case at bar. The Seventh Circuit acknowledged the uncontroverted fact that plaintiff does not use any of the Fund's special cash-management services which the other shareholders use, and hence, she has a special interest in eliminating the fees for those services. Indeed, the Seventh Circuit acknowledged "that most other shareholders believe that the Fund's special services are worth the 0.2% cost." (Pet. App. 26a.) Nonetheless, the Seventh Circuit held that plaintiff's inadequacy can be solved by treating her lawyer as the true representative and by allowing him free reign to advocate at trial a contrary

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[7] *See also, e.g., Owen v. Modern Diversified Indus.* 643 F.2d 441, 442-43 (6th Cir. 1981); *Bailey v. Ryan Stevedoring Co.*, 528 F.2d 551, 553 (5th Cir. 1976), *cert. denied*, 429 U.S. 1052 (1977).

position — that the Fund's special services are not worth the cost.

If this Court reviews other issues in this case, it should grant this cross-petition for at least two reasons.

First, the Seventh Circuit's view misses the thrust of *Hansberry*'s due process concern by failing to recognize that plaintiff's lawyer is subject to the same conflicts as the plaintiff and that the lawyer cannot advocate a position opposed to the expressed interests of the class. In theorizing that the absent shareholders will be injured only if the ultimate judgment is wrong (Pet. App. 27a), the Seventh Circuit fails to acknowledge that plaintiff (and her lawyer) are obligated to be advocates — "volunteer champions" of the interests of the absent shareholders. *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 549 (1949). They cannot, consistent with due process, champion a cause different from that which the absent shareholders would champion.[8]

Second, the Seventh Circuit's view that plaintiff's inadequacy can be solved by substituting her lawyer as the class representative contradicts this Court's holding that named plaintiffs must be members of the class they purport to represent. *Bailey v. Patterson*, 369 U.S. 31, 32-33 (1962). It also contradicts the principle that named plaintiffs (like their counsel) must act with "diligence, wisdom and integrity" in their prosecution of the litigation because their role is "one of a fiduciary character." *Cohen v. Beneficial Industrial Loan Corp.*, 337 U.S. 541, 549 (1949). Moreover, the Seventh Circuit's holding that a derivative plaintiff can know "little about either the Fund or the case" and can give "counsel free reign" (Pet. App. 25a) conflicts with numerous cases from other circuits that follow *Cohen* in holding that derivative

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[8] Plaintiff's lack of common interest with the other shareholders prejudices KFS by subjecting KFS to collateral attack of a favorable judgment (*see Hansberry*) and by forcing KFS to defend against an atypical plaintiff at trial.

plaintiffs must be attentive and diligent in the prosecution of the suit. *See, e.g., Rothenberg v. Security Management Co.*, 667 F.2d 958, 962 (11th Cir. 1982); *Davis v. Comed, Inc.*, 619 F.2d 588, 593-94 (6th Cir. 1980).

The issue of plaintiff's adequacy is important because the potential effect of the Seventh Circuit's holding may extend beyond Section 36(b) litigation and affect the law in all types of representative lawsuits, including derivative suits and class actions. If this Court grants review in No. 90-516, it also should grant review with respect to this issue.

CONCLUSION

If this Court grants the petition in No. 90-516, this cross-petition also should be granted.

Respectfully submitted,

Joan M. Hall*
Joel T. Pelz
C. John Koch
JENNER & BLOCK
One IBM Plaza
Chicago, Illinois 60611
(312) 222-9350

Attorneys for Cross-Petitioner Kemper Financial Services, Inc.

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* Counsel of Record